Item 546-B GAI-13: HRD-80-102 Jan.

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BY THE COMPTROLLER GENERAL

Report To The Chairman
Committee On Government Operations
House Of Representatives
OF THE UNITED STATES

COMPLETED

ORIGINAL

Service Contract Act Should Not Apply To Service Employees Of ADP And High-Technology Companies

On June 5, 1979, the Department of Labor ruled that all Federal contracts for the maintenance and repair of ADP, telecommunications, and other high-technology commercial equipment are subject to the wage determination and other requirements of the Service Contract Act.

GAO believes the act was not intended to cover maintenance services related to commercial products acquired by the Government. Labor made no feasibility, cost/benefit, or impact studies to support its ruling.

The ruling will impose an undue financial and administrative burden on the affected companies. Furthermore, wage protection for these service workers is not needed. In addition, the ruling may cause Federal agencies to eliminate or curtail many crucial programs and services.

The Congress should act to exclude Federal contracts for ADP and other high-technology commercial product-support services from Service Contract Act coverage.

SUMMARY

(12)

HRD-80-102
SEPTEMBER 16, 1980

COMPTROLLER GENERAL'S REPORT TO THE HOUSE COMMITTEE ON GOVERNMENT OPERATIONS

SERVICE CONTRACT ACT SHOULD NOT APPLY TO SERVICE EMPLOYEES OF ADP AND HIGH-TECHNOLOGY COMPANIES

D I G E S T

The Service Contract Act of 1965 protects workers' wages on Federal contracts when the contracts' principal purpose is to provide services in the United States using service employees. For contracts over $2,500, the minimum wages and fringe benefits must be based on rates the Secretary of Labor determines as prevailing for service employees in the locality.

LABOR'S CONTROVERSIAL DECISION

On June 5, 1979, the Department of Labor notified the General Services Administration (GSA) that the maintenance and repair services specifications of all Federal contracts for the purchase or rental of supplies or equipment were subject to the act. Previously, GSA and other Federal contracting agencies had not considered these contracts to be subject to the act.

Soon thereafter, several major automatic data processing (ADP) and other equipment manufacturers announced their refusal to accept any Government contract subject to the act. (See pp. 1 to 3.)

THE COMMITTEE'S REQUEST

Labor's decision could seriously affect maintenance and repair of the Government's computers--more than 14,300 computers valued by GSA at more than $5.4 billion--many of which are critical to national defense and security. On November 23, 1979, the Chairman, House Committee on Government Operations, asked

GAO to review Labor's decision. Later, the Committee's Ranking Minority Member asked GAO to broaden its study to cover other commercial equipment industries affected by Labor's decision. (See pp. 3 to 5.)

LABOR'S EFFORTS TO IMPLEMENT ITS DECISION

Contractor refusals to accept the act's coverage caused immediate problems for Government agencies in awarding contracts.

To alleviate the immediate impact, on August 10, 1979, Labor granted a 90-day temporary exemption from the act's coverage for certain ADP and telecommunications equipment purchase or rental contracts. Contracts for maintenance and repair services only and those involving high-technology and other commercial products were not exempted. Federal agency requests that Labor also exempt maintenance-only contracts were generally denied.

At the end of the 90 days, Labor decided not to extend or make permanent its temporary exemption. Thereafter, Labor has required that all contracts with equipment maintenance and repair specifications contain the applicable provisions of the act and Labor's wage and fringe benefit rate determinations.

However, to further minimize the initial impact of its decision and to buy time while appropriate wage and fringe benefit data could be gathered from the ADP industry, on November 30, 1979, Labor issued an interim, nationwide wage determination covering ADP maintenance and repair services. This determination accepted currently paid wages and fringe benefits as prevailing for such services. Nevertheless, major ADP and other equipment manufacturers continued to reject Government contracts subject to the act.

By March 1980 Labor had developed a proposed average entrance-level wage rate of $5.24 to be the minimum hourly rate that could be paid to the industry's service technicians subject to the act. Labor planned to apply the rate nationwide to all ADP, scientific, and medical apparatus equipment maintenance and repair contracts and contract specifications, and to GSA's Federal Supply Service schedule contracts for purchase and rental of automated office/ business machines and related equipment having maintenance and repair specifications.

In early June 1980, a senior Labor official advised the industry that this rate would be issued soon. However, Labor's attorneys raised serious legal and policy questions concerning use of a nationwide entrance-level wage rate. In mid-June, Labor shelved the $5.24 rate and issued wage determinations that, in effect, extend and expand the November 1979 interim determination, while Labor officials continue to study the problem. (See pp. 30 to 39.)

LABOR'S DECISION INAPPROPRIATE

Labor contends that the act applies to all contracts, as well as any contract specification, whose principal purpose is to provide services through use of service employees.

GAO believes Labor's position is not supported by the act's language and legislative history, by Labor's own regulations, or by its administrative manual.

The Service Contract Act was not intended to cover maintenance services related to commercial products acquired by the Government. ADP, high-technology, and other commercial product-support service contracts, where Government sales represent a relatively small portion of a company's total

sales, do not have the same characteristics, or incentives, for contractors to deliberately pay low wages to successfully bid on Government contracts.

Accordingly, Labor's application of the act to contractor services sold primarily in the commercial sector, such as provided by ADP and other high-technology industries, in GAO's view, is inappropriate. (See pp. 8 to 29.)

LABOR'S WAGE PROTECTION UNNEEDED

The industries' central argument, that the act's application to commercial product-support services is not needed, has merit.

GAO contacted 18 corporations that manufacture, sell, and service ADP, high-technology, and other equipment. These corporations stressed their belief that the act's intent was not to cover industries providing commercial product-support services to the Government at established catalog prices. Of these corporations, 17 presented convincing evidence to GAO through financial statements, payroll records, price catalogs, and other documents that the act should not apply because:

--Substantial quantities of their products and services are sold commercially at established catalog prices.

--Government business represents a small portion of their total business.

--Their field service technicians receive adequate wages under merit pay systems, thereby eliminating the need for wage protection.

The most significant force behind the act was the Congress' desire to eliminate "wage busting" and prevent payment of substandard wages to persons whose employment either

totally or substantially depended upon Government contracts awarded solely on the basis of price competition. Industry contended, Labor officials acknowledged, and GAO's review confirmed, that wage busting is not a problem in these industries. (See pp. 40 to 55.)

INDUSTRY COMPLIANCE WOULD BE COUNTERPRODUCTIVE AND COSTLY

Without an exemption or indefinite continuance of the interim determinations, Labor's decision to enforce the act's coverage would adversely affect operations in the ADP, office equipment, and other scientific and high-technology industries.

The most serious concerns presented by the 18 corporations GAO contacted were that Labor's decision would eventually

--increase the administrative burdens and operating costs of each corporation and

--hinder employee productivity and morale by disrupting merit pay systems and staff assignment practices.

In addition, several corporations stressed the inflationary impact Labor's wage determinations could have on the industries' wage rates.

One corporation said a new system estimated to cost almost $1 million would be needed to track data on employees servicing approximately 700,000 machines within the Government. Another corporation estimated that the cost to develop and implement new data processing systems and modify existing systems would be $1.5 to $2 million. A third corporation estimated the cost to design, develop, and install its system at over $1 million, with annual maintenance costs of $250,000.

The first corporation also stated that, to maintain its merit pay system and still comply with the act, a separate work force would have to be created for the Federal contracts. To do this, the corporation estimated it would incur developmental and implementation costs of $9.35 million--including the almost $1 million for a new system--and annual recurring costs of $3.3 million.

One corporation said the first-year inflationary impact on its field service technician wages would be $648,000. Another corporation estimated the impact at $12 million. A third and much larger corporation said the inflationary impact on technician wages would be $100 million the first year. (See pp. 56 to 76.)

IMPACT ON FEDERAL AGENCY OPERATIONS

GAO obtained information on the act's application at 114 Federal agency installations. At 42 of the installations, contracting difficulties developed because contractors refused to accept contracts subject to the act.

To minimize impact or avoid shutdown of programs and activities, agency contracting officials either awarded contracts during Labor's 90-day exemption period or circumvented the act by:

--Issuing numerous purchase orders valued under $2,500 (22 installations).

--Designating or accepting contractor designations that the service technicians assigned to the contract qualified as exempt professionals (7 installations).

--Exercising contract options, extending terms, or adding to the scope of existing exempt contracts, sometimes due to misinterpretation of instructions (3 installations).

--Issuing delivery orders against GSA's exempt fiscal year 1980 ADP schedule contracts (10 installations).

At 21 of the installations, agencies also attempted or considered attempting to acquire maintenance services through third-party contractors--firms other than the original equipment manufacturers. Some third-party arrangements proved successful; others did not.

One Army installation had to permanently shut down its $12 million computer system because the sole-source contractor would not accept a follow-on maintenance contract containing Service Contract Act provisions. The system is expected to be scrapped, and replacement computer services are being obtained from sources at much higher cost and considerable inconvenience.

Various Federal officials cited other impacts they believe would occur if maintenance and repair services under existing contracts expiring during fiscal year 1980 were discontinued and could not be renewed.

--Complete stoppage of the space shuttle program.

--Inability to monitor and record vital signs of critically ill or postsurgical patients at a veterans' medical center.

--Loss of support to U.S. Army Health Service Command activities throughout the world.

--Delay or shutdown of test and research programs on the F-15 and F-16 fighters and B-1 bomber.

--Serious programmatic impact on the design, development, test, production, and retirement of nuclear weapons.

Presently, many major corporations strongly object to coverage under the act in any form but appear willing to accept contracts containing Labor's latest interim wage determinations, including GSA's proposed fiscal year 1981 ADP schedule contracts. However, they caution that this situation might exist only as long as the interim wage determinations remain in effect.

If the Labor/industry basic disagreement on the act's coverage is not permanently resolved, GAO believes the future impact on Federal agency programs and operations could be severe. (See pp. 77 to 91.)

RECOMMENDATIONS

The Congress should amend the Service Contract Act to make it clear that the act excludes coverage for ADP and other high-technology commercial product-support services--i.e., services the Government procures based on established market prices of commercial services sold in substantial quantities to the public.

Pending such action by the Congress and to avoid further serious impairment to the conduct of Government business, the Secretary of Labor should temporarily exempt from the act's coverage certain contracts and contract specifications for ADP and other high-technology commercial product-support services. (See pp. 96 and 97.)

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At the request of the House Committee on Government Operations, GAO did not follow its normal practice of obtaining advance agency and industry comments on the report.

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ABBREVIATIONS

ADP	automatic data processing
BLS	Bureau of Labor Statistics
CBEMA	Computer and Business Equipment Manufacturers Association
DOD	Department of Defense
GAO	General Accounting Office
GSA	General Services Administration
IBM	International Business Machines Corporation
NASA	National Aeronautics and Space Administration
NSA	National Security Agency
OFPP	Office of Federal Procurement Policy
SAMA	Scientific Apparatus Makers Association
SCA	Service Contract Act of 1965, as amended
VA	Veterans Administration